Surge Petroleum Inc.

Annual Report 2000

CDNX – SPY

www.surgepetroleum.com

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ANNUAL MEETING

The annual meeting of shareholders will be held on Tuesday, June 19, 2001 at 2:30 p.m. at The 400 Club, 710 – 4th Avenue S.W., Calgary, Alberta in the McDougall Room.

CORPORATE PROFILE

Surge is a publicly traded junior oil and gas company with a balanced production and exploration portfolio. Surge has a strategy to increase shareholders' value, to have continued growth and to manage risk without limiting upside. The Company is staffed with a dedicated group of seasoned oil and gas professionals with track records as oil finders and company builders.

Surge trades on The Canadian Venture Exchange with the stock symbol "SPY".

2000 Highlights

Surge Petroleum Inc. was incorporated on July 1, 2000 with the amalgamation of Aegis Energy Inc., Peregrine Oil and Gas Ltd. and Plexus Energy Ltd. As a result of combining these companies, oil industry numbers with respect to finding costs and operating costs, are not relevant. During the third and fourth quarter of 2000, strategies and capital programs were developed to reflect the new Company's corporate focus and a strong experienced, multi-disciplinary management team was formed.

As a result of combining these three companies, Surge has a large inventory of attractive natural gas projects. These prospects have been developed internally using detailed stratigraphic mapping, combined with geophysical structural interpretations from our 6,000+ miles of 2-D seismic. The Company holds a 50 percent interest in 50,000 acres over these prospects.

During the year 2001, the Company's financial resources will be directed towards developmental drilling, completions and pipeline connections to market our gas reserves. Our exploration wells will be developed using third party funding. Cash flow generation is our prime objective. Capital spending for 2001 is estimated at $2,300,000.

Surge raised $909,000 for the year 2000, bringing the shares issued to 11,830,274. We are planning a combination flow-through share and straight equity issue in 2001 to accelerate development of our cash flow properties. We intend to limit new share sales to avoid dilution of the Company unnecessarily at the beginning of what is predicted to be an exceptional five to ten year period of high oil and gas demand.

Surge's working capital surplus is $444,640 with no long-term debt and with retained earnings.

Cash flow from operations in 2000 was $508,144 or $0.05 per share. Surge Petroleum Inc. has produced an average of 110 bbls per day of oil and 230 mcf per day of natural gas for the year 2000, an equivalent of 148 barrels of daily production. The Company has targets to double cash flow through 2001 from the natural gas discoveries made to date. With success from the planned drilling, our targets are to increase cash flow by more than three times 2000 levels.

Earnings in 2000 were $249,794 or $0.02 per share. The Company has a target to double earnings through 2001, which will result from the success of our planned drilling program to date.

Surge has four shut-in gas wells ready for pipeline connections to market. Plans for 2001 include the drilling of six development gas wells and two horizontal development oil wells.

Two exploration wells will be drilled and three geophysical programs will also be run in 2001. From this new geophysics, combined with our existing inventory of plays, we will bring additional prospects to the drilling stage in 2001 and for subsequent years.

President's Letter to Shareholders

I am pleased to report that the industry is now in a major upswing. Oil prices are over $25 US per barrel and are expected to remain over $20 US per barrel. Gas prices have climbed from under $2.00 US per mcf into the $5.00 US to $7.00 US per mcf levels and are expected to remain over $4.50 US per mcf for the next five to ten years.

Surge and most other oil companies are reporting increases in profitability. Many of the junior and most of the medium sized Canadian oil companies have been sold or have disappeared into royalty trust companies during the past year. This leaves a void in the exploration side of our business. It now seems evident that the junior oil companies will play a major role in exploration for resources in North America. Companies like Surge, with cash flow and access to equity capital, will combine this with their core group of professionals and land inventory and will profit from the supply side of this excellent oil and gas market.

Surge has an opportunity to grow through exploration, yet manage risk by inviting third party participation in our exploration wells, trading a portion of the upside in our plays for risk dollars.

Surge will continue to evaluate acquisitions where we can identify significant potential though the use of our local knowledge and technologies. At present, prices being asked for producing properties are very high. We will not make purchases that do not bring significant potential for added value.

The Company is still at a stage where new equity is important to maintain our growth targets. We will restrict ourselves to small placements so as to maintain the total shares outstanding relatively low, which in turn will enable our successes to have a material impact on the share price.

The management and staff of Surge Petroleum have budgeted for significant growth in 2001. We believe this will translate into a comparable increase in shareholder value.

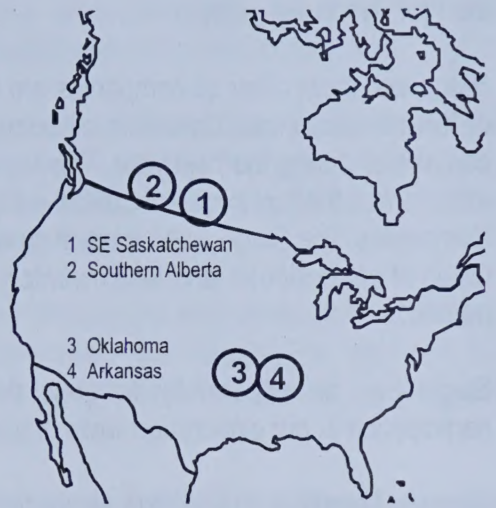
All of us at Surge Petroleum wish to thank you, our loyal shareholders, for your continued support.

Frank P. Elliott, P.Geol.
President and Chief Executive Officer
May 9, 2001

Projects

Strategies:

CANADA



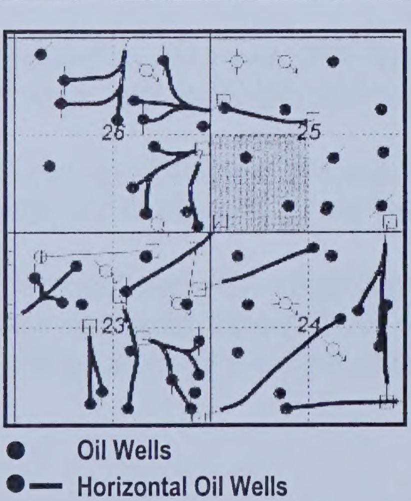
Surge Petroleum will be focused on adding value to our proven oil properties in Canada through horizontal drilling technology and water flood pressure enhancement. Canada will also be our primary area for acquisitions. Properties must have significant proven upside that will add value above the purchase price of the properties.

USA

Our focus in the United States is within the Arkoma Basin, a gas prone area where the Company has a strong knowledge base and where large areas of potential gas lands are available. We have many "man-years" of detailed mapping that when combined with our 6,000+ miles of 2-D seismic; have afforded the Company with a large inventory of gas prospects. Our emphasis will be focused on development of the gas discoveries plus continuing exploration on new projects using risk management tools to reduce our risk without limiting the upside on our projects.

The Company will initiate its projects with a high working interest ownership and prior to drilling, will sell at a marked up cost, a portion of the working interest to third parties. We trade our experience; added land value and seismic inventories in return for the risk dollars required to drill the first exploration wells on each prospect. The Company intends to maintain a 25 percent working interest in each prospect.

Development:



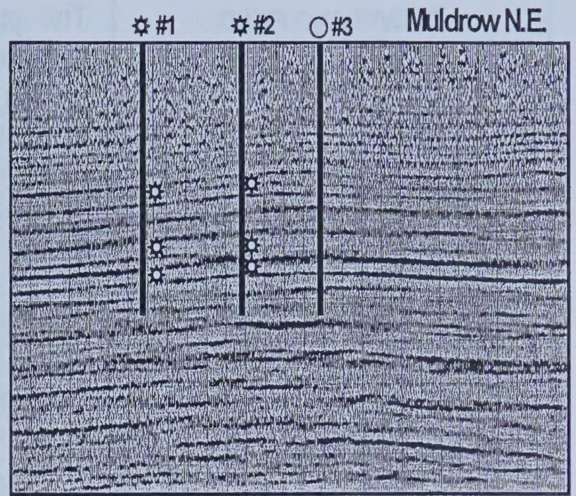
Lougheed (Saskatchewan)

Lougheed, in southeastern Saskatchewan, is an example of the potential to make a sound production purchase and then through the drilling of a horizontal development well to significantly add value to the property. This property averaged 20 barrels of oil per day and the horizontal development well is expected to add 90 barrels per day. There is potential to drill a second horizontal well after confirming the success of the first development well.

The Company has a 32 percent working interest in these lands.

Muldrow NE (Oklahoma)

This project is an excellent example of the shallow multi-zone gas potential within the Arkoma Basin. The play is controlled structurally with three gas pay zones developed over the structure. Three wells have been drilled to date and two additional wells are planned for 2001, with provision for the field to expand into several other sections. Reserve estimates vary from 0.2 bcf in the very shallow zones to 3.0 bcf per section in the deeper zones which occur at 2,400 feet. This prospect is an excellent example of Surge trading expertise for risk dollars. Surge held a 50 percent interest in this prospect; the test well was drilled using third party dollars (at no cost to Surge). The Company retains a 25 percent working interest in the project including all development wells.

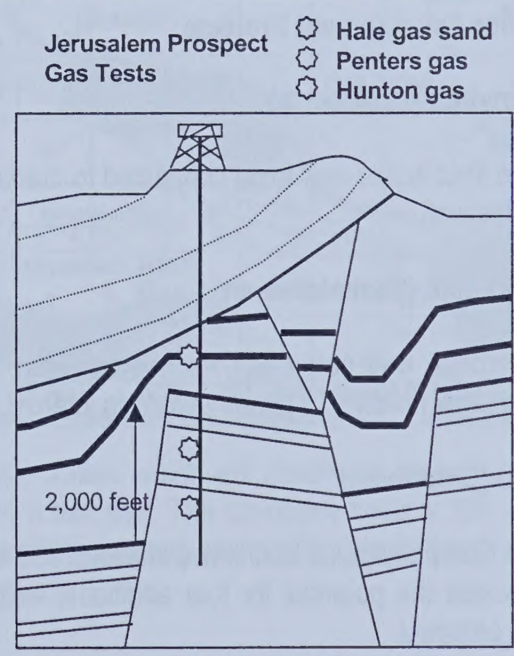


Seismic Line Through Discovery Well and offset locations

Jerusalem (Arkansas)

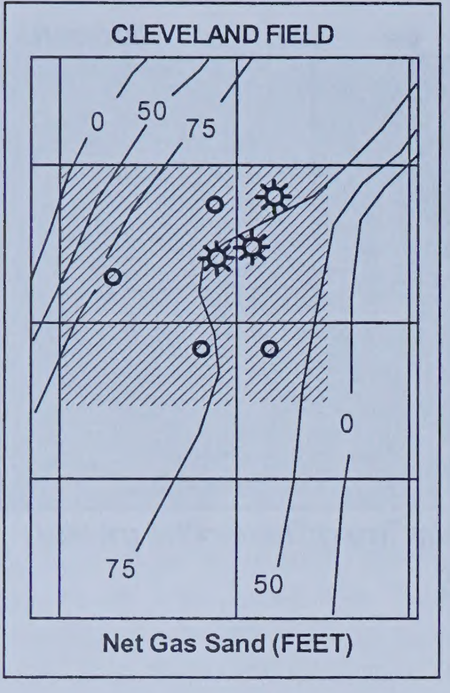
This discovery exploration well was drilled with the use of risk management tools, which reduced the dry hole cost of the test well to the Company. The prospect is over a structure with 1,000 feet of closure and has encountered three potential gas pay zones. The well was drilled using air drilling technology and burned gas at over 500 mcf per day during the final five days of drilling. Natural gas was encountered immediately upon entering the first zone. The secondary zones contain gas and will require fracture treatment and testing before proving their significance. The main gas sand will be tied into sales lines as soon as testing is completed.

We have lands for three or more offset wells and will prepare the locations for drilling after confirmation of reserve size and production rates from the discovery well. The Company has a 25 percent interest in this play.



Cross-section through discovery well

Cleveland (Arkansas)



This play results from the effect of the higher gas prices on prospect economics. The field was discovered in 1998 in a remote area in the Arkoma Basin. It was later suspended at 500 mcf per day of gas. Prices were just over $1.00 per mcf and the water, which was produced along with the gas, was too expensive to be trucked to the nearest water disposal location. Now at $4.50 per mcf the economics justify re-activating the wells and drilling offset locations. The size of this field has not yet been determined, however mapping indicates potential for several sections of pay area. The Company plans to reactivate the existing three gas wells and to drill two additional wells this year. Plans are to convert one well to a water disposal well to optimize the project economics.

The Company holds a seventy percent working interest in this project.

Other Development Projects:

Manyberries (Alberta)

One shut in gas well to be connected to markets. The Company holds an 11.47 percent working interest in this well.

Workman (Saskatchewan)

Horizontal well potential. As non-operator, Surge has proposed drilling infill wells in this unit. The Company holds a 15 percent working interest.

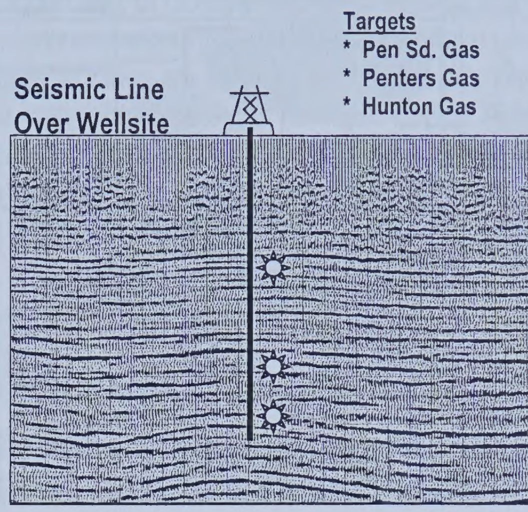
Rott (Oklahoma)

The Company plans to drill two shallow (850 feet) development wells in June 2001. Geological mapping indicates the potential for four additional wells. The Company holds a 50 percent working interest on this prospect.

Exploration:

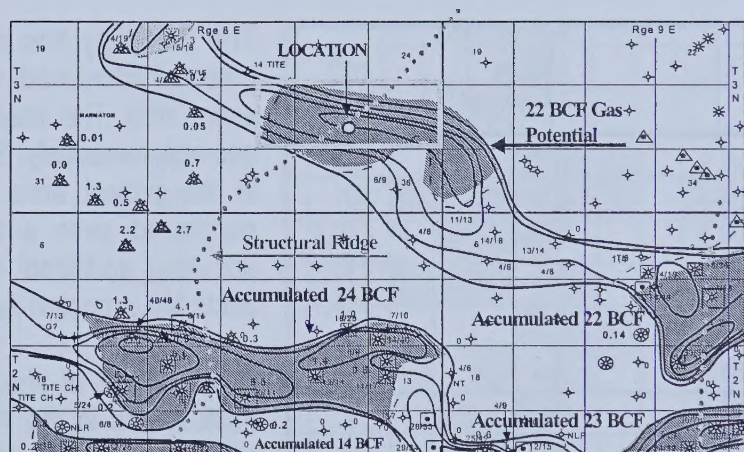
Center Ridge (Arkansas)

This prospect has potential for multiple pay zones trapped over a closed structure. Three of the main target gas zones have calculated reserve potential of over 10 BCF per well. The prospect was developed internally and the 4,500 foot test well is to be drilled in 2001. The Company held a 50 percent working interest in the play lands and has traded its value in land, seismic and expertise in exchange for risk dollars to drill the test well. The Company will retain a 25 percent working interest in this prospect.

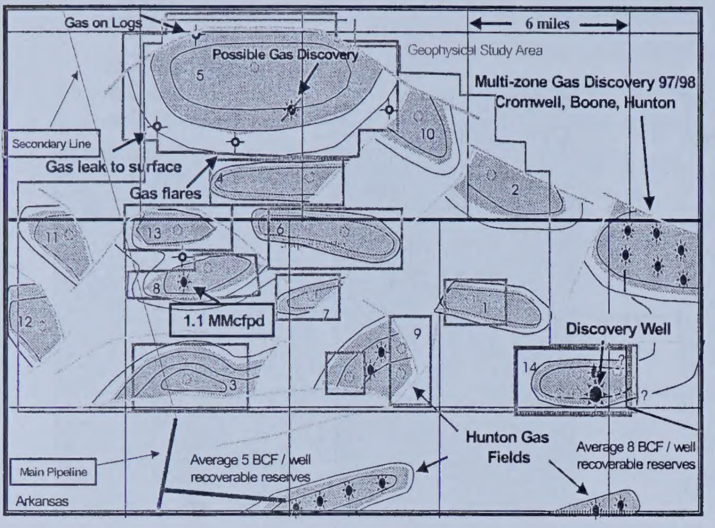


Sand Creek (Oklahoma)

This prospect has the potential for multiple pay zones which are trapped statigraphically over a southwest plunging structure. These main gas zones have calculated reserve potential of over eight BCF per well. The prospect was developed internally and a 5,000 foot test well is to be drilled in 2001. The Company held a 100 percent working interest in the play lands and has traded a portion of value in land, seismic and expertise in exchange for risk dollars which will contribute towards shooting a confirmation seismic program to be followed by a test well. The Company holds a 100 percent interest in this play and will retain a 50 percent working interest after drilling the first test well.

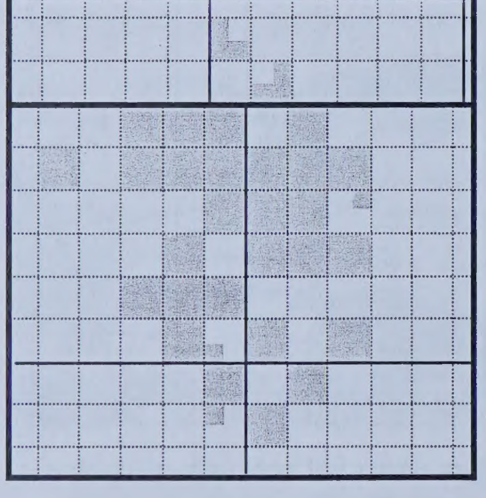


Brushy Mountain (Oklahoma)



This prospect covers a five-township area with evidence confirming the presence of multiple closed structures, each with multiple gas zone potential. The Company has a 50 percent working interest on this project with over 11,000 acres leased to date. A large geophysical survey is planned to define the closure on each structure. The Company anticipates defining eight or more potential gas fields from this study. Drilling is expected to commence in 2002. An internal evaluation by the Company has defined potential of 70 bcf of recoverable gas from this project.

Bos (Alberta)



The Company has identified an area with shallow gas sand potential combined with multiple coal beds throughout the entire area. The intent is to develop the shallow gas and coal gas simultaneously. Surge holds a 33 percent working interest in the project area. Various interests in lands have been purchased over a thirty-section block. Surge is currently acquiring additional lands in the area. Operations on these lands are expected to commence in late 2001.

Development of shallow coal for natural gas has a proven track record in the Arkoma Basin. Surge believes we have large areas in Alberta where this technology will apply. If that is the case, Surge will strive to be one of the leaders in coal bed methane production in Alberta.

Keota (Oklahoma)

The Keota prospect is on a known structure with over 2,000 feet of closure. 2-D seismic over this larger structure shows evidence of a pronounced smaller Hunton remnant structure that is a potential gas trap. Similar structures immediately south have produced gas at rates up to eight mmcf per day per well. Typical individual fields are 80 to 360 acres in size and hold recoverable gas reserves of 8 to 10 bcf per structure. The Company is running a 3-D survey to confirm the remnant structure's prospective size. At present, the Company holds a 50 percent working interest in the play lands and plans to farmout a portion of this prospect, retaining a 25 percent working interest in the test well.

Oil and Gas Reserves

Chapman Petroleum Engineering Ltd. and Fekete Associates Inc., independent petroleum engineering firms, have evaluated the oil and natural gas reserves, land and seismic for Surge Petroleum Inc. as of December 31, 2000.

Reserves and Value

	Reserves Before Royalties		Present Worth of Reserves	
	Oil and Liquids mbbl	Gas Mmcf	Discounted at 10% Thousand $	15%
Proven Producing	305	507	3,973	3,323
Proven Undeveloped	80	706	1,502	1,183
Total Proven	385	1,213	5,475	4,506
Probable	123	275	1,504	1,144
Total Proven Plus Probable	506	1,488	6,979	5,650
Land Value			9,461	9,461
Seismic Data Value			7,168	7,168
Grand Total			$23,608	$22,279

Profiles

The senior management in Calgary includes Frank Elliott, Peter Sametz, Murray Ryan, and Robert Hobbs. These individuals have extensive industry experience in Canada, the USA and Internationally. They have worked together for many years and have a track record of successful business developments.

Frank P. Elliott, P. Geol., President & Director
Mr. Elliott is an exploration geologist, a 1968 graduate of N.A.I.T. and holds a geological degree from the University of Calgary (1976). Mr. Elliott was the President of Peregrine Oil and Gas, a predecessor company to Surge. He is also the C.E.O. and Director of Jerez International Inc. Mr. Elliott has been responsible for many significant field discoveries in Canada, the United States and Internationally and has assisted, founded and developed several public companies.

Robert R. Hobbs, C.M.A., Chief Financial Officer & Director
Mr. Hobbs was the President of Plexus Energy Ltd. since July 31, 1998 until the merger between Plexus Energy Ltd., Peregrine Oil and Gas Ltd., and Aegis Energy Ltd. He is also the President of R.R. Hobbs Financial Consultants Ltd. since 1983. Mr. Hobbs is also a director of Niko Resources Ltd. and Jerez Energy International Ltd.

Peter D. Sametz, P.Eng. Chief Operating Officer & Director
Mr. Sametz, a professional engineer, was founder and principal of inline petroleum management, a consulting company specializing in heavy oil since 1997. He was Vice President, Production for ELAN Energy. Mr. Sametz was president and director of Aegis Energy Ltd., a predecessor company to Surge Petroleum Inc. He has been involved in the innovative application of new technology and has experience in growing oil and gas companies from junior to senior status.

Murray T. Ryan, Senior Geologist
Mr. Ryan has a proven record of success in both the exploration for and exploitation of hydrocarbon reservoirs in Western Canada and is an expert in horizontal drilling applications. Prior to joining Surge in September 2000, Mr. Ryan was an associate with Tethys Energy Inc.

Jeffrey J. Scott, Director
Mr. Scott is President and Chief Operating Officer of Jerez Energy International Inc. since 1996. He is also Vice President of Postell Energy Co. Ltd. a private oil and gas producer since 1986. In addition, Mr. Scott serves on the Board of Directors of Jerez Energy International Inc., Klinair Environmental Technologies and Fan Energy Inc. He is a past director of Cenalta Energy Services, Petrowell Services, Jettstar Resource Services, Aegis Energy Ltd., Rosebay Resources and Goldwater Resources.

Other key team members in Calgary include Carol Mohitpour, Controller; Dawn Bishop, Assistant Corporate Secretary-Accountant; Trish Hall, Executive Assistant-Technician; Dwaine Korsbrek and Mena Vargas, Land Consultants and Daryl Wanner, Field Supervisor.

Whit Whitmire is the general manager of Arkana Operating Co. Inc. (Surge's US subsidiary) and is the on site manager of its office located in Tulsa, Oklahoma. Whit is a geologist and geophysicist with 41 years of industry experience including 29 years with Texaco US as Exploration Manager. Whit was in charge of 19 states situated in the southern United States. Whit is widely recognized as one of the foremost experts on the Arkoma Basin. Other key team members in Tulsa include Delbert Goodin, Land Manager; Bruce Galbierz, Operational Engineer and Tom Grier, Geophysical Consultant.

Auditors' Report

To the Shareholders of Surge Petroleum Inc.

We have audited the consolidated balance sheets of Surge Petroleum Inc. as at December 31, 2000 and 1999 and the consolidated statements of income and retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2000 and 1999 and the consolidated results of its operations and cash flows for the years then ended in accordance with generally accepted accounting principles.

Davis, Daignault, Schick & Co.

CALGARY, Alberta
April 4, 2001

Chartered Accountants

Financial Statements

Consolidated Balance Sheet
As At December 31

	2000	1999
ASSETS		
Current		
Cash	$ 626,709	$ 191,698
Accounts receivable	508,728	316,832
Deposits and prepaids	96,493	61,165
	1,231,930	569,695
Investment in private company	158,412	77,980
Capital – Note 3	8,087,520	7,990,381
Future tax benefits	-	333,032
	$9,477,862	$8,971,088
LIABILITIES		
Current		
Accounts payable and accrued liabilities	$ 571,991	$ 336,629
8% convertible debentures – Note 4	215,299	704,023
	787,290	1,040,652
Long-term debt	-	130,000
Provision for site restoration costs	145,216	37,138
	932,506	1,207,790
SHAREHOLDERS' EQUITY		
Capital stock – Note 6	8,295,562	9,132,477
Retained earnings (deficit)	249,794	(1,369,179)
	8,545,356	7,763,298
	$9,477,862	$8,971,088

Director: [signature]

Director: Robert R Hobbs

Consolidated Statement of Income and Retained Earnings
For the Years Ended December 31

	2000	1999
Revenue		
Oil and gas revenue net of royalties	$1,436,845	$1,030,885
Expenses		
Depletion and amortization	282,936	274,818
General and administrative	374,853	364,395
Interest on long-term debt	17,393	63,427
Well operating	511,869	430,001
	1,187,051	1,132,641
Income (loss) before income taxes	249,794	(101,756)
Future income taxes – Note 7	-	37,952
Net income (loss) for the year	249,794	(139,708)
Deficit, beginning of year	(1,369,179)	(1,229,471)
Future tax benefit reversed on amalgamation	(333,032)	-
Organization and other costs written off on amalgamation	(165,086)	-
Applied to share capital	1,867,297	-
Retained earnings (deficit), end of year	$ 249,794	$(1,369,179)
Income (loss) per share:		
Basic	$ 0.02	$ (0.01)
Fully diluted	$ 0.02	$ (0.01)

Consolidated Statement of Cash Flows
For the Years Ended December 31

	2000	1999
Operating activities:		
Net income (loss) for the year	$ 249,794	$ (139,708)
Adjustments to reconcile income from operations to net cash provided:		
Depletion and amortization	174,858	261,673
Provision for site restoration	108,078	13,145
Future income taxes	-	37,952
	532,730	173,062
Changes in operating assets and liabilities:		
Accounts receivable	(191,896)	(118,562)
Deposits and prepaids	(35,328)	(5,642)
Accounts payable and accrued liabilities	235,362	(47,899)
Accrued debenture interest	(32,724)	48,023
Cash flows from operating activities	508,144	48,982
Investing activities:		
Sale of capital assets	870,609	7,500
Investment in private company	(80,432)	(1,033)
Capital assets acquired	(1,186,676)	(775,305)
Cash flows used in investing activities	(396,499)	(768,838)
Financing activities:		
Repayment of long-term debt	(130,000)	-
8% convertible debentures	(456,000)	-
Proceeds of share issue, net of issue costs	909,366	542,288
Cash flows from financing activities	323,366	542,288
Net increase (decrease) in cash	435,011	(177,568)
Cash, beginning of year	191,698	369,266
Cash, end of year	$ 626,709	$ 191,698
Cash flow per share:		
Basic	$ 0.05	$ 0.02
Fully diluted	$ 0.04	$ 0.01
Supplementary information:		
Interest paid	$ 50,117	$ 15,404
Taxes paid	$ -	$ -

Notes to Financial Statements

Note 1: Basis of Presentation

These consolidated financial statements have been prepared on the going concern basis that contemplates the realization of assets and settlement of liabilities in the normal course of business.

The Company's activities over the past four years have been primarily directed towards the acquisition, exploration and development of natural gas properties in Oklahoma and Arkansas. The Company's primary assets are the exploration and drilling rights acquired on blocks of land in those two States. The Company is still assessing the potential of these blocks of land and, as such, has not attained production at commercial levels. All costs related to exploration and development in the United States, net of incidental revenues, are being capitalized. Realization of these assets is dependent upon the discovery of petroleum and natural gas reserves in commercial quantities and upon the Company raising debt or equity financing or entering into additional joint venture agreements with third parties to provide the funds required to continue the exploration and development of this property.

Note 2: Significant Accounting Policies

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles and reflect the following policies:

a) Business combination

Surge Petroleum Inc. was formed on July 1, 2000 through the amalgamation of Aegis Energy Ltd. (Aegis), Plexus Energy Ltd., (Plexus) and Peregrine Oil and Gas Ltd. (Peregrine). Prior to the amalgamation Aegis, Plexus and Peregrine were under common control in that the companies had a high percentage of common equity holders, common directors and operated in many of the same geographic areas. The combination has, therefore, been accounted for in a manner similar to the pooling of interest method whereby the consolidated financial statements reflect the combined carrying values of the assets, liabilities and shareholders' equity and the combined operating results of Aegis, Plexus and Peregrine for all periods presented, both pre and post amalgamation.

Under the terms of the amalgamation arrangement each Aegis shareholder received one Surge common share in exchange for 3.3 Aegis shares, each Plexus shareholder received one Surge common share in exchange for 2.8225 Plexus shares, and each Peregrine shareholder received one Surge share in exchange for 3.6474 shares.

A summary of the book values of the assets and liabilities at the date of the amalgamation is presented below:

	Aegis	Plexus	Peregrine
Assets:			
Current	$259,724	$202,651	$130,303
Capital	1,099,760	3,036,481	3,887,456
Other	234,432	38,000	41,633
	1,593,916	3,277,132	4,059,392
Less:			
Current liabilities	240,719	137,632	130,867
Future removal and site restoration costs	13,400	13,023	16,777
Net assets	$1,339,797	$3,126,477	$3,911,748

The operating results of Aegis, Plexus and Peregrine for the six months ended June 30, 2000, are as follows:

	Aegis	Plexus	Peregrine
Revenue – net of royalties	$ 599,019	$ 134,948	$ 108,887
Expenses			
Depletion and amortization	92,491	20,890	13,469
General and administrative	87,861	58,886	52,624
Well operating	213,244	44,078	48,205
Net income (loss) before taxes	$ 205,423	$ 11,084	$ (5,411)

Third party costs to effect the amalgamation were charged to accumulated deficit at the amalgamation date. These costs totaled $121,016 and included regulatory filing fees, legal, accounting and engineering fees, and printing and mailing costs.

The consolidated financial statements have been adjusted to standardize the accounting methods used by the three companies. The primary activity of the amalgamated company is directed towards the acquisition, exploration and development of natural gas properties in the United States. The combined company has some production in Canada, however, it can generally be considered to be in the start-up or pre-production stage. Prior to amalgamation only Aegis was considered to be in full production. Plexus and Peregrine were exploration companies. Aegis had recorded future tax benefits, which are not appropriate for an exploration company. These future tax benefits, which totaled $333,032 on Aegis' books, were charged to accumulated deficit at the amalgamation date. The accumulated deficit of the combined companies at the amalgamation date was reduced to nil by a charge to share capital.

b) Basis of Consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries; Plexus Resources Inc., Peregrine Oil and Gas Inc., AJS Energy Inc., and Arkana Operating Co. Inc.

c) Petroleum and Natural Gas Properties

i) Capitalized Costs

The Company follows the full cost method of accounting for oil and gas operations, whereby all costs associated with the exploration for, and development of, oil and natural gas reserves are capitalized by cost centre. The Company operates in two cost centers, Canada and the United States of America. Such costs include property acquisition expenditures, geological and geophysical expenses, carrying charges of non-productive properties, costs of drilling productive and non-productive wells, and plant and production equipment costs. Financing and administrative costs are capitalized only to the extent that they are directly related to capital projects. Proceeds from the sale of any interests in oil and gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a disposition would alter the rate of depletion by at least 20%.

ii) Canadian Cost Centre

Costs accumulated in the Canadian cost centre are depleted using the unit-of-production method based on estimated net proven reserves, as determined by the Company and reviewed yearly by independent consulting engineers. Natural gas production and reserves are converted to equivalent units of measure using a relative energy content.

The Company applies a ceiling test to the costs of developed properties to ensure that capitalized costs (net of accumulated depletion) do not exceed the estimated future net revenues from production of proven reserves less estimated future administrative, financing and income tax costs. Future net revenues are based on prices and costs prevailing at the year-end.

iii) United States Cost Centre

Activities in the United States are in the pre-production stage as exploration and early development continues to determine if reserves in economic quantities can be extracted. Accordingly all costs incurred in this cost centre have been capitalized. Depletion of these costs will not commence until production at economic levels has been attained.

The Company annually reviews the capitalized costs associated with this cost centre to determine whether they are permanently impaired.

When costs are not likely to be recovered, a provision for impairment is made.

Unimpaired costs associated with the acquisition and evaluation of significant unproved properties are excluded from amounts subject to the ceiling test.

d) Other Capital Assets

Amortization of other equipment is provided using the declining balance method at rates ranging from 20% to 30% per annum.

e) Future Site Restoration Costs

Future site restoration and reclamation costs are amortized using the unit of production method. These costs are based on management's estimates of the anticipated costs of site restoration net of expected recoveries. Removal and site restoration costs will be charged against the accumulated provision as incurred.

f) Measurement Uncertainty

The amounts recorded for depletion and amortization of capital assets and the provision for future site restoration costs, are based on estimates of reserves and future costs. By their nature, these estimates and those related to future cash flows used to assess impairment are subject to measurement uncertainty and the impact on future financial statements resulting from changes in such estimates could be material.

g) Joint Ventures

Substantially all of the Company's oil and gas related activities are conducted jointly with others and, accordingly, these consolidated financial statements reflect only the Company's proportionate interest in such activities.

h) Flow-through Shares

Resource expenditure deductions funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. Petroleum and natural gas properties and share capital are reduced by the estimated cost of the renounced tax deductions when the expenditures are incurred.

i) Investments

Long-term investments are carried at cost less permanent declines in value.

j) Earnings and Cash Flow Per Share

Earnings per share amounts have been computed using the weighted average number of shares outstanding during the year. A fully diluted earnings per share assumes the exercise of all options and convertible debentures.

k) Financial Instruments

The Company's financial instruments are comprised of accounts receivable, deposits and prepaids, accounts payable and accrued liabilities and convertible debentures.

i) Fair Value of Financial Assets and Liabilities
The fair values of financial instruments approximate their carrying amount due to the short-term maturity or capacity for prompt liquidation.

ii) Credit Risk
Virtually all of the Company's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks.

iii) Foreign Currency Risk
The Company is exposed to foreign currency fluctuations as oil and gas prices received are based on U.S. dollar denominated world prices.

Note 3: Capital Assets

i) 2000

	Cost	Accumulated Amortization	Net Book Value
Oil and Gas properties	$9,906,140	$1,879,123	$8,027,017
Other equipment	99,589	39,086	60,503
	$10,005,729	$1,918,209	$8,087,520

ii) 1999

	Cost	Accumulated Amortization	Net Book Value
Oil and Gas properties	$9,658,476	$1,722,541	$7,935,935
Other equipment	83,356	28,910	54,446
	$9,741,832	$1,751,451	$7,990,381

During the year ended December 31, 2000, the Company capitalized $264,480 (1999 – $211,938) of general and administrative expenditure relating to exploration and pre-production activities.

The cost of unproved property excluded from the depletion base as at December 31, 2000 was $6,632,262 (1999 - $6,314,903).

Oil and gas properties with a net book value of $104,511 (1999 - $116,760) have no tax base.

Note 4: 8% Series II Convertible Debentures

The Company has pledged as security for the debentures all of the issued and outstanding shares of its wholly owned subsidiaries and its interest in an oil well. The debentures, with a term of one year, are convertible into common shares of the corporation at the election of the holders based on the average trading price of the common shares. On January 17, 2001, the convertible debentures were converted to an 8% Series I debenture with the same security and conversion rights as the 8% Series II debenture. The 8% Series I debenture is due on January 1, 2002, or earlier if demanded. These debentures have been subordinated to the bank credit facility described in Note 5.

Note 5: Long-term Debt

The Company has an undrawn bank credit facility available to a maximum of $950,000 at December 31, 2000. This loan has no fixed terms of repayment and is subject to a periodic review by the lender. Amounts outstanding bear interest at bank prime plus 1.0% and are secured by a $5,000,000 floating debenture and general security agreement over the Company's assets.

Note 6: Share Capital

a) Authorized

An unlimited number of Class "A" common shares
An unlimited number of Class "B" preferred shares

b) Issued:

	Number of Common Shares	$
Balance, December 31, 1998	9,545,387	$8,590,188
Private placements	549,100	551,480
Special warrants converted	216,593	-
Options exercises	20,455	10,125
Cancelled	(61,194)	-
Share issue costs	-	(19,316)
Balance, December 31, 1999	10,270,341	9,132,477
Private placement	474,729	332,310
Flow through share private placement	255,500	178,850
Debentures converted	729,704	504,023
Issued to pursuant to management compensation plan – Note 6 d)		
- vested	45,788	36,630
- non-vested	54,212	-
Share issued costs		(21,431)
Pre-amalgamation deficit applied to share capital	-	(1,867,297)
Balance, December 31, 2000	11,830,274	$8,295,562

Note 6: Share Capital – Continued

c) Share purchase warrants outstanding

Balance December 31, 1999	Exercise Price	Expiry Date	Expired	Issued	Balance December 31,2000
465,152	$0.83	April-June, 2000	(465,152)	-	-
242,424	$1.91	June, 2000	(242,424)	-	-
99,723	$1.41	January-March, 2000	(99,723)	-	-
89,835	$1.82	January-March, 2000	(89,835)	-	-
35,430	$0.85	April, 2001	-	-	35,430
27,417	$1.09	April, 2001	-	-	27,417
-	$0.75	May, 2001	-	85,715	85,715
-	$0.75	June, 2001	-	151,650	151,650
959,981			(897,134)	237,365	300,212

d) Stock based compensation plans

Surge has a stock option plan under which directors, officers, employees and consultants to the company, receive options to purchase common shares of the Company at stated prices. These options may be exercised at any time up to the expiry date. Stock option plans of Aegis, Plexus and Peregrine were continued under the amalgamation arrangement by applying the common share amalgamation ratio to the options and option prices.

Year Option Granted	Expiry Date	Options Outstanding	Exercise Price
1997	June 18, 2002	69,191	$0.50
1999	June 23, 2004	9,091	$0.56
1999	June 23, 2004	4,545	$0.66
2000	July 13, 2005	80,000	$0.70
2000	July 13, 2005	890,814	$0.90
		1,053,641	

During the year the Company entered into contracts with certain senior management whereby it agreed to issue 100,000 common shares upon completion of the service contracts. At December 31, 2000, 45,788 shares had vested and were recorded at $0.80 per share as issued share capital and general and administrative expense. 54,212 shares remain unvested at December 31, 2000.

e) Flow through shares

On December 31, 2000, the Company completed the private placement of 255,500 flow-through Class "A" common shares at $0.70 per share. Under the terms of the flow-through share agreement, the Company has committed to incur and renounce $178,850 of resource expenditure by December 31, 2001. The paid up amount for the flow-through shares and the cost of petroleum and natural gas properties will be reduced by the estimated tax benefits renounced.

f) Trading restrictions

482,885 of the issued shares are subject to escrow trading restrictions.

Note 7: Income Taxes

Income taxes differ from the results, which would be obtained by applying the combined federal and provincial income tax rates to earnings before income taxes.

The difference results from the following:

	2000	1999
Effective tax rate	45.38%	44.62%
Computed expected tax provision (recovery)	$113,357	$(45,161)
Effect on taxes of:		
Non-taxable items	(46,975)	16,946
Share issue cost amortization	(39,223)	(47,681)
Loss carry-forward benefit not recognized	(27,159)	113,848
	$ -	$ 37,952

The Company has available approximately $5,078,000 in loss carry forwards and tax pools, the benefit of which has not been recognized in these financial statements.

Note 8: Segmented Information

The Company is involved in the exploration and development of petroleum and natural gas properties in Canada and the United States of America. Operations and identifiable assets by geographic region are as follows:

	2000	1999
Revenue		
Canada	$1,436,845	$1,030,885
Operating income (loss)		
Canada	249,794	(101,211)
United States	-	(545)
Identifiable assets		
Canada	2,413,313	2,242,970
United States	7,064,549	6,728,118
Capital expenditures		
Canada	2,518	383,344
United States	264,480	391,961

Note 9: Related Party Transactions

a) Consulting fees of $96,155 (1999 - $ nil) were paid to companies controlled by directors of Surge Petroleum Inc.

b) 8% convertible debentures in the amount of $215,299 (1999 - $704,023) are held by companies controlled by directors of Surge Petroleum Inc. (see Note 4).

Note 10: Commitments

The Company is committed under a lease agreement for the rental of premises to the following annual payments, exclusive of realty taxes and other charges:

2001	$43,368
2002	$43,368
2003	$43,368
2004	$43,368
2005	$28,912

Note 11: Comparative Figures

The comparative figures have been reclassified to conform with the current year's presentation.

Corporate Information

Officers and Directors

Frank P. Elliott, P.Geol.
Director, President & Chief Executive Officer

Robert R. Hobbs, C.M.A.
Director, Chief Financial Officer, Secretary

Peter D. Sametz, P.Eng.
Director, Chief Operating Officer

Jeffrey J. Scott, M.B.A.
Director

Murray T. Ryan
Senior Geologist

Carol Mohitpour, BSc.
Controller

Dawn Bishop, B.Comm.
Assistant Corporate Secretary

Transfer Agent and Registrar

Computershare Investor Services
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EMAIL: info@surgepetroleum.com
Website: www.surgepetroleum.com

Bankers

National Bank of Canada
Calgary, Alberta, Canada

Reserve Engineers

Chapman Petroleum Engineering Ltd.
Calgary, Alberta, Canada

Auditors

Davis Daignault Schick & Co
Calgary, Alberta, Canada

Shares Listed

Canadian Venture Exchange
Surge Petroleum Inc. ("SPY")

Legal

Gregory C. Collver
Paul D. Trotter